

LNA Santé – Performing a LBO in the French Home Care Market

Marta Maria Ortigão Costa Ribeiro | 25833

A Project carried out on the Master in Finance Program, under the supervision of:

Professor Luís Mota Duarte  
Professor Fábio Soares Santos

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## LNA Santé – Performing a LBO in the French Home Care Market

### Abstract:

Begun operating in 1992 and today is ready to be bought and to grow massively in the upcoming years. LNA Santé, the fifth French player in the long-term care market, will be acquired in 2019 in a Private Equity deal and will improve its operations in Europe. This deal is expected to return 3.1x the money invested by the fund and an internal rate of return of almost 26% with an exit in five years (2023). This successful exit is possible due to an ageing population that is set to increase demand for dependent care which is reflected in the number of nursing home beds forecasted to double.

By the time of exit, the firm will amount €828 M of revenues and €94 M of EBITDA streaming from consolidation of operations in the current operating countries – France and Belgium – and an internationalization bet in the Netherlands. It is presumed that this paper will inform how a deal in Private Equity in the long-term care market in Europe is conducted.

### Key words:

Long-Term Care Market, Nursing Home, European Market, LNA Santé

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# LBO Model

# LBO MODEL | Returns

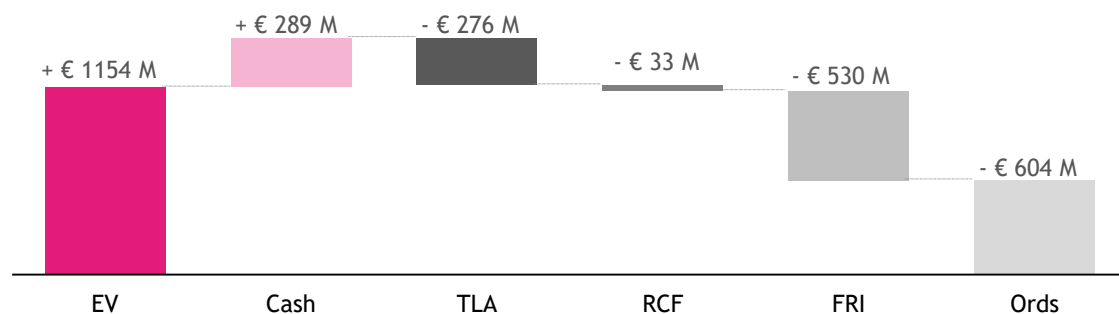
The operating model and defined capital structure will yield an IRR of 25,6% and a Money Multiple of 3.1x for an exit in 2023

## 1 Expected Returns

		IRR					MM Fund		
		2022	2023	2024			2022	2023	2024
Exit Multiple	11.3x	29,0%	24,6%	21,9%	Exit Multiple	11.3x	2.8x	3.0x	3.3x
	11.8x	30,3%	25,6%	22,6%		11.8x	2.9x	3.1x	3.4x
	12.3x	31,8%	26,7%	23,4%		12.3x	3.0x	3.3x	3.5x

- The **Institutional Returns** MM will be 3.1x and the IRR 25,6% in 2023. The fund will enter with an investment of €330 M and see its equity stake grow to €1033 M where €530M come from the FRI and €503 M from institutional ordinary shares.
- The **Management Returns** MM will be 13.8x in 2023. The management will enter with €3,6 M in the form of Sweet Equity, and see that value grow to €50 M.

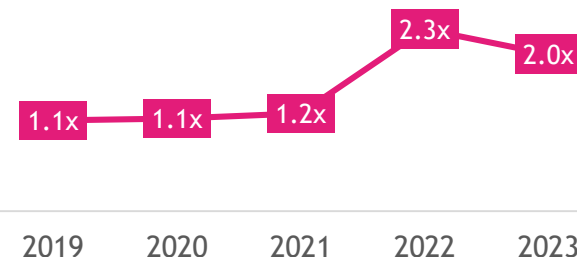
## 2 Exit Waterfall



- Entry:** With an entry multiple of 11.8x and an EBITDA of €50,2 M in 2018, LNA Santé will be acquired at an Enterprise Value of €591 M.
- Exit:** Assuming no value creation regarding multiple arbitrage, the company will have an exit EV of €1154 M in 2023.

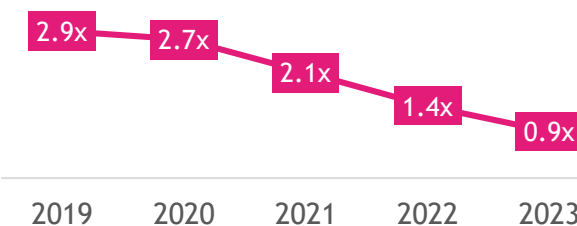
## 3 Credit Stats

### Cash Cover



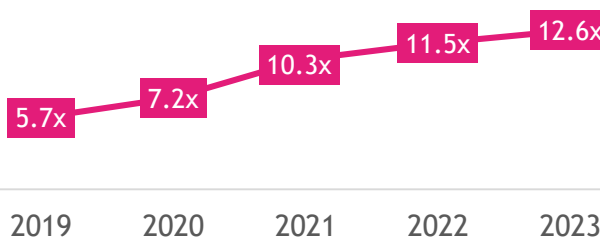
- Cash Cover** is subject to the expansion CAPEX needs and the TLA. Throughout the holding period, LNA will be able to sustain most of the debt incurred.

### Net Debt/ EBITDA



- Net Debt / EBITDA** decreases over time. The Revolving Credit Facility allied with a strong cash generation, will allow LNA to benefit from a light debt profile.

### Interest Cover

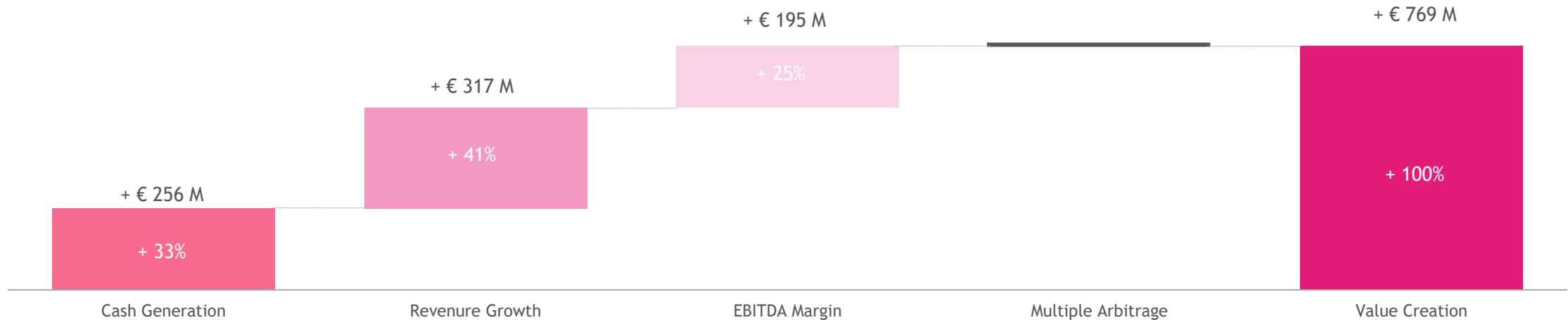


- Interest Cover** presents a positive behaviour due to an EBITDA that grows faster when compared to the interest obligations.

# LBO MODEL | Value Creation Breakdown

Revenue growth will be the highest source of value for this investment. Operational margin improvements detailed in the Investment Thesis will see the value of LNA increasing by €195 M

## 1 Value Creation Breakdown

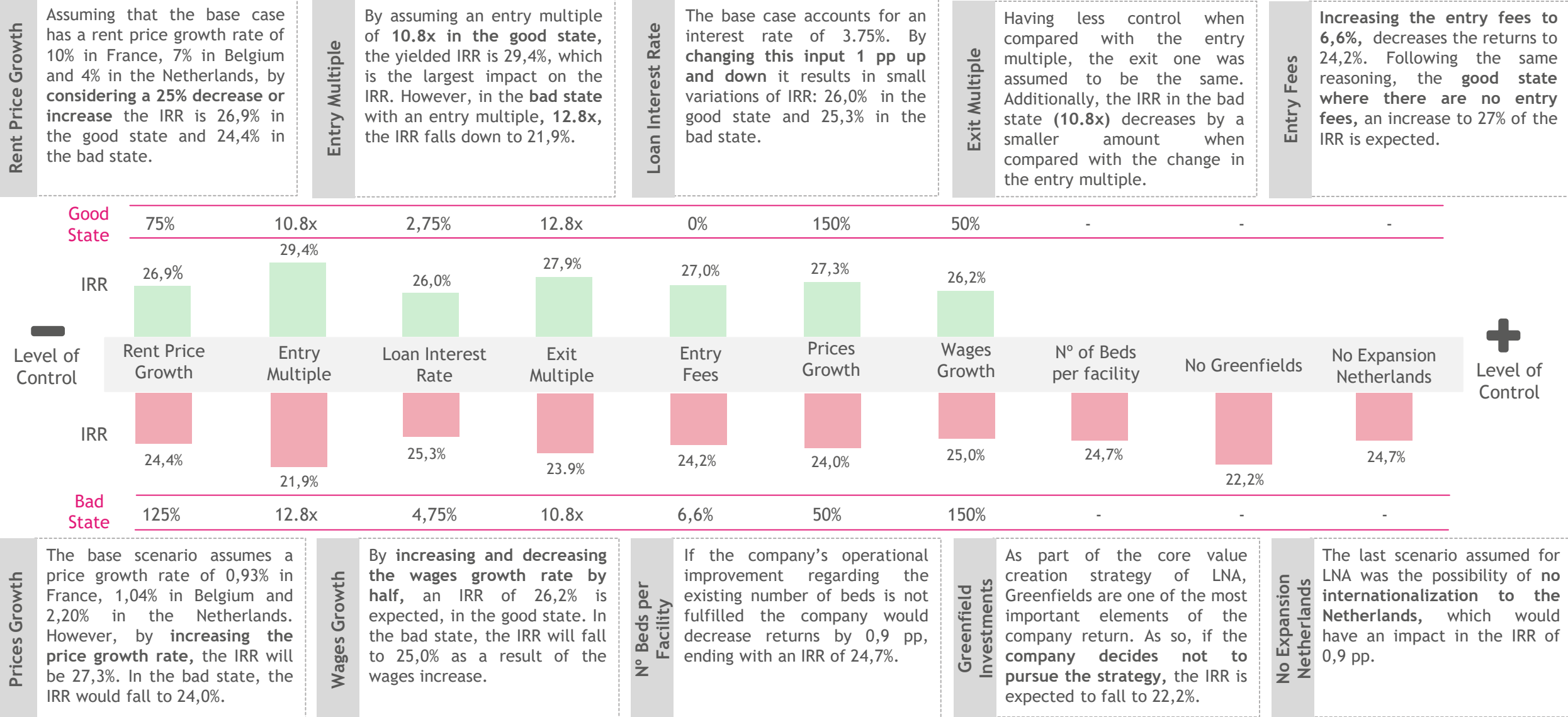


## 2 Total Value Creation during the holding period is + 769 M€

- **Cash Generation:** throughout the 5-year holding period, LNA will be able to use its cash-flow to face most of the debt schedule. The fact that the principal of the Bank Loan will only be repaid in 2024, adding to the usage of the RCF will allow LNA to have no debt by year 2025.
- **Revenue Growth:** the conservative expansion strategy that will be pursued, will yield a 7-year CAGR of revenues of around 7%. Inorganic growth will be tied to a considerable investment in the first 3 years of the holding period - 6 constructions of new facilities that are expected to be fully operational by the end of 2021. Acquisition of 2 small players in France, 1 in Belgium and 1 in the Netherlands, will also provide an early boost in the level of revenues.
- **EBITDA Margin:** severe due diligence will be pursued in order to confirm the inefficiency of the company's operations. LNA has a higher 'employee/bed' ratio when comparing with its peers in the market. Furthermore, the current prospect of the firm, that will also be pursued by our team, is to gradually increase the 'average number of beds per facility'. Combining this two levers, we believe that LNA's EBITDA margin will benefit from an increase in 2 pp, resulting in a value creation of + €769 M.
- **Multiple Arbitrage:** given the current market conditions, it was assumed that the returns will not benefit from multiple arbitrage. This way, the exit and entry multiple will be the same.

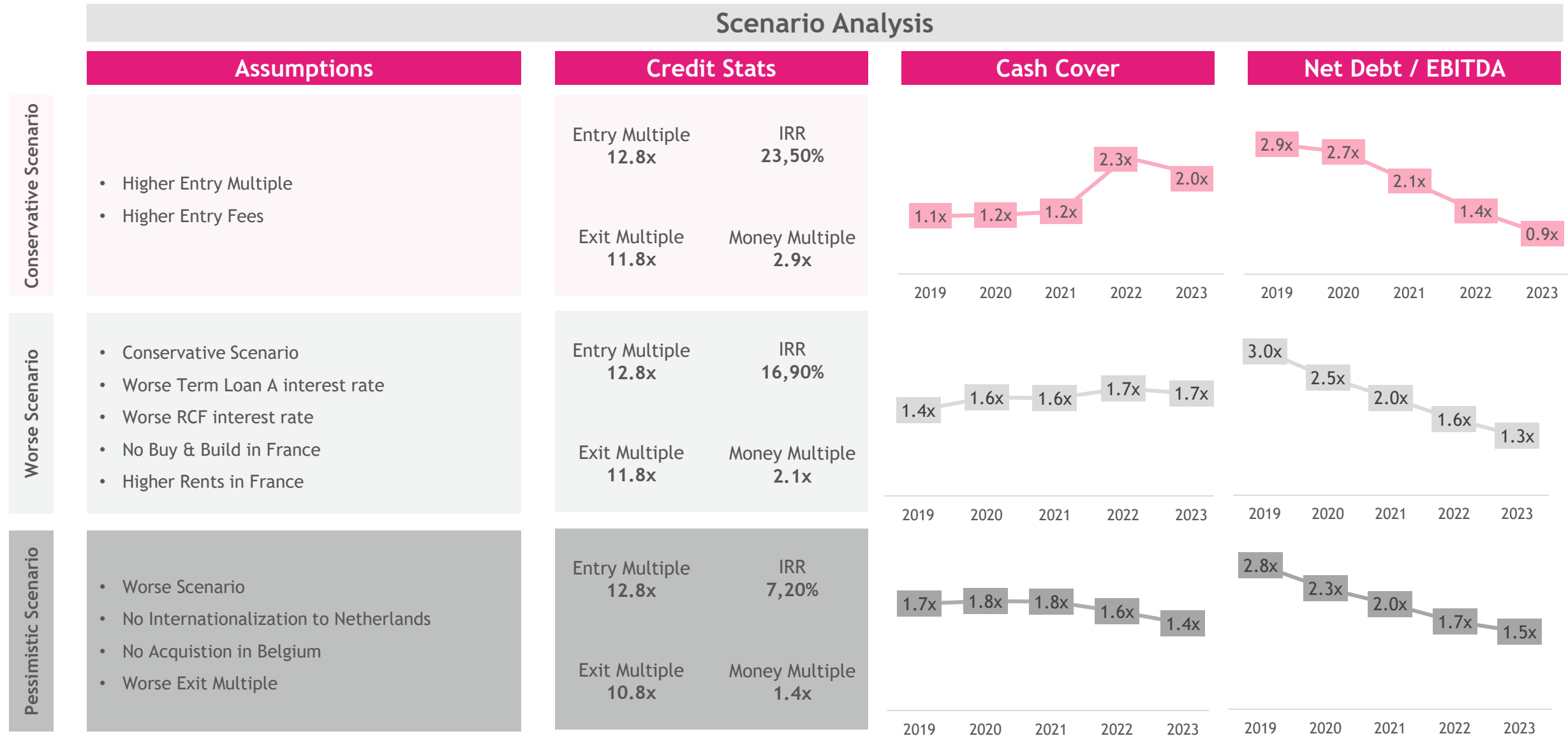
# LBO MODEL | Sensitivity Analysis

The base case scenario yields an IRR of 25,6% and a money multiple of 3.1x. Diverse scenarios were created by changing the inputs according to a good and a bad state, generating different IRRs



# LBO MODEL | Scenario Analysis

Assuming that no proposed strategy is achieved, in the Pessimistic Scenario LNA will still yield a meaningful return for the fund. This reflects the potential of LNA Santé as a target and business model





# Exit Options



# EXIT OPTIONS | Exit Strategy

Our team is focused on exiting through a strategic sale of LNA Santé. European groups such as Orpea and Korian are two possible buyers

## 2<sup>nd</sup> Secondary Sale

A Secondary Sale to another Private Equity fund occurs when there is still significant growth potential for the company and the current fund is planning on exiting.

- Our team has identified that there will still exist significant growth potential opportunities at the exit date. The prospect of continuing expansion in Europe's neighbour countries as well as the potential to follow market trend and internationalize further to South America can entice some PE firms to acquire LNA Santé.
- A possible buyer would have to be a PE firm with relationship with the industry and locations where LNA is currently operating.
- EQT seeks high-quality, market-leading, medium sized to large companies in Europe and US. The fund counts with diverse investments in the healthcare industry, with one nursing home in Germany.



Private Equity Funds may not understand the complexity of providing a “public service”. The temptation for employee shortage is not a good practice in this industry.



## 1<sup>st</sup> Strategic Sale

Strategic Sale is performed to a company that will benefit from synergies and is willing to pay a premium on the acquired company.

- Assuming an exit multiple range of 10.5x-12.5x to EBITDA, it is expected that a big and well positioned player will be able to acquire LNA Santé and benefit from existing synergies.
- **Orpea** has been actively investing in increasing its market share in France to compete with its rivals Domus VI and Korian. **Acquiring LNA Santé would be very beneficial for Orpea** to assure its dominant position in the French market.
- **Korian** would also be interested in acquiring LNA Santé. In the recent past, Korian has acquired players in Spain and Germany. By acquiring LNA, Korian would become the largest player in France by number of beds.



One of the reds flags that may arise with selling to another industry player is that the current management may not be needed for the future of LNA Santé.



## 3<sup>rd</sup> Initial Public Offering

Typically occurs when the company is having difficulties to find a strategic partner to acquire the operations or when the exit value is too high.

- The upside of an IPO strategy is that the pool of investors increases, and in this case the market seems favourable. These conditions may often lead to high exit values.
- These days, Nursing Homes industry is often put on the spotlight due to its stable cash flow generating characteristics. Being listed in a major stock exchange is sometimes perceived as a prestige position for a company.
- Undergoing an IPO is a very expensive operation that requires a lot of time. Additional expenses would have to be incurred in order to hire an investment bank to oversee the process.



IPOs are highly dependent on the cycle of the market. The fact that the current market may seem favourable, at exit it may not happen.



# EXIT OPTIONS | Target Buyers

Our team is focused on exiting through a strategic sale of LNA Santé. European groups such as Orpea and Korian are two possible buyers



## Orpea

### Current largest nursing homes operator in France

- Orpea started operating in France in 1989 as provider of Assisted Living services for the elderly. Undergoing an IPO in 2002 has allowed for it to build a strong reputation in Europe, allowing for internationalization in 2004 to neighbor countries in Europe.
- So far, Orpea has been expanding at a fast rate. As of today, the company is present in 12 European countries, China, Brazil, Uruguay and Chile.

Market Cap  
€7,2 Bn

#Beds World  
96 577

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## Korian

### 2<sup>nd</sup> largest nursing homes operator in France

- Korian was born of the merger of 4 other companies. In 2006 when they entered in the stock market, Korian set itself as “ an expert in care and support services for the elderly”.
- Currently manages Europe’s leading network of nursing homes, specialized clinics, assisted living facilities, hospital care and home-care services.
- Specialized in the European geography, Korian extends its services to 4 other European countries.

Market Cap  
€3,3 Bn


#Beds World  
81 594


# Due Diligence



# DUE DILIGENCE | Commercial and Regulatory


An in-depth Due Diligence will be crucial for an early detection of possible issues in the following areas: commercial, regulatory, human resources, valuation, financial and exit



Commercial			
Key Areas of Analysis		Red Flags	Providers
Market Sizing	<ul style="list-style-type: none"> <li>Check industry's saturation rate.</li> <li>Look into the market sizing forecasts and dynamics.</li> </ul>	<ul style="list-style-type: none"> <li>Assess if the market is growing at the expected rates. Make sure the increase in capacity that each country needs is accurate and aligned with LNA's expected growth.</li> <li>Understand if Home Care service is the next <i>chicken of the golden eggs</i> in the market. See if the firm's approach is the most innovative and cost-effective strategy. Control for other players entering in the market.</li> <li>Re-assess if the real state strategy is optimal or weather it is decreasing efficiency or even not profitable enough.</li> <li>Find out if the overhead costs can be maintained when acquiring smaller companies and with further internationalization.</li> </ul>	<p>McKinsey &amp; Company</p>  <p>BAIN &amp; COMPANY</p> <p>Expected Duration: 8 weeks</p>
Competition	<ul style="list-style-type: none"> <li>Check sustainability of LNA's position in the European nursing home industry as well as the current market share of the company within each segment.</li> </ul>		
Business Model	<ul style="list-style-type: none"> <li>Deeper analysis regarding applied prices, occupancy rates, ratio of beds per facility and employees per bed.</li> <li>Get insights regarding operating costs breakdown by segment. Check if there are any inefficiencies.</li> <li>Feasibility of real state strategy.</li> </ul>		
Acquisitions	<ul style="list-style-type: none"> <li>Determine if the impact of continuous M&amp;A activity has increasing value for the company.</li> <li>Assess if acquired companies are correctly integrated and synergies realized.</li> </ul>		
Customer Satisfaction	<ul style="list-style-type: none"> <li>Determine customer health progress and its satisfaction through surveys.</li> </ul>		

Regulatory			
Key Areas of Analysis		Red Flags	Providers
Licensing	<ul style="list-style-type: none"> <li>Assess if more licenses are going to be granted in a near future as well as the risk of greater intervention by governments and regulators.</li> <li>Understand the requirements regarding facilities expansion, greenfields, the acquisition in the Netherlands and the HC strategy.</li> </ul>	<ul style="list-style-type: none"> <li>Figure out what is the license pipeline for the next years and how will LNA leverage its impact.</li> <li>Possible future law that would reduce the occupancy rates per facility: decrease the number of beds per room.</li> <li>Potential decrease of subsidies by the government which could put pressure to decrease prices for customers.</li> </ul>	 <p>Expected Duration: 4 weeks</p>
Operations	<ul style="list-style-type: none"> <li>Deeper analysis regarding the different types of prices set by the government: accommodation, dependency and care rates.</li> <li>Investigate weather the government will increase or decrease its expense in subsidizing elderly for nursing home care.</li> </ul>		

# DUE DILIGENCE | HR and Financial

Work force, Internal Processes and Property Management are three important areas that must be thoroughly analyzed to better appraise the firm's expected operation

Human Resources			
	Key Areas of Analysis	Red Flags	Providers
Work Force	<ul style="list-style-type: none"><li>• Get a deep understanding of the individuals and the management team so that motivation, skillsets and any potential gaps are determined. Place the best team to deliver the plan.</li><li>• Identify LNA working culture and make sure that it identifies to the acquired firms. Confirm that internal processes are not rushed so that a deep and robust acquisition is conducted.</li><li>• Assess if employees are motivated and aligned with the new strategy by reviewing internal processes, employment policies, contracts and pension plans. Encourage employees to accept the change specially in the acquired firms.</li><li>• Assess the need for continuous formations and workshops for nurses and staff in order to keep educating employees and keep the firm up to date to the new healthcare practices.</li></ul>	<ul style="list-style-type: none"><li>• Possibility to damage key employee relationships during the deal construction.</li><li>• Difficulty to sustain the current level of quality with a reduced number of employees per facility and by acquiring different operators.</li><li>• Difficult to attract employees to the new built areas.</li><li>• Lack of communication between nurses in the new Home Care teams in the Netherlands.</li></ul>	<div></div>
Internal Processes			
Recruitment			
			Expected Duration: 8 weeks

Financial			
Key Areas of Analysis		Red Flags	Providers
Accounting	<ul style="list-style-type: none"><li>Detailed analysis of all the financial statements and pay special care to the acquired firms. Understand the profitability by segment and look for possible fraud or misstatements.</li><li>Look into Goodwill and Intangible assets and assess the accuracy of its valuation.</li><li>Make sure the firm is reporting all its debt so that the net-debt is not understated. Perform a deeper analysis on NWC.</li><li>Guarantee that the standards of quality of the infra-structures and buildings are achieved and maintained over time. Control and perform frequent profitability analysis with major incidence for the new properties acquired.</li><li>Assess the rent payments in all areas that LNA operates and the maintenance CAPEX necessary in each facility.</li><li>Ensure tax compliance with special care in the entering firms.</li><li>Analyze how the current tax structure is able to create opportunities for LNA and if it is fully optimized.</li></ul>	<ul style="list-style-type: none"><li>Possible mismatch of specific fundamentals and accuracy of financial statements. Pay special attention to EBITDA bellow estimated or overestimated Goodwill.</li><li>Assess the market's movements in terms of rental yields and how it would affect the business with a sharp increase.</li><li>Bad assessment of Maintenance Capex and the need to increase this expenditure.</li><li>Oscillation in taxes, as recently seen in France.</li></ul>	
Property Management			
Tax			
			Expected Duration: 8 weeks



# DUE DILIGENCE | Others and Valuation

After approximately 8 weeks of investigation, LNA Santé will have an excellent report of its operations and surrounding market with the possible risks and overcoming strategies pointed-out. Overall, €1,8 M will be spent in this evaluation

## Others

### Key Areas of Analysis

IT	<ul style="list-style-type: none"> <li>How much should R&amp;D spending increase to keep up with the future trends of the market, mainly in the home care segment and in telemedicine.</li> </ul>
Logistics	<ul style="list-style-type: none"> <li>Make sure all the facilities are up to date with the instruments necessary to offer the most efficient and technological service in the market.</li> </ul>
Environmental	<ul style="list-style-type: none"> <li>Define a strategic supply chain department that takes into account the expansion network and makes surveillance of the good and aligned operation of each facility in each region and country. Re-assess the efficiency and sustainability of the already existing supply chain.</li> </ul>
Insurance	<ul style="list-style-type: none"> <li>Make sure the constructions held by LNA Santé are in line and compliant with each country's legislations in terms of environmental figures.</li> <li>Insure all LNA Santé's employees of possible malpractices and also insure the firm for possible malpractices from directors and management.</li> <li>Understand which insurances are necessary to protect the clients and the firm in each segment and country of operation.</li> </ul>

### Red Flags

- Sharp increase in costs to modernize each facility.
- Big restructure of the existing supply chain that might imply the increase of undesired costs.
- Malpractices in the healthcare industry are a risk for the brand's name and for a big infrastructure as LNA Santé.
- Make sure there are surveillance teams for irregular behaviors from employees and the management of each facility.

### Providers

McKinsey  
& Company



Expected Duration:  
6 weeks

## Valuation

### Key Areas of Analysis

Valuation	<ul style="list-style-type: none"> <li>Request an independent valuation, with detailed cash generation, EBITDA margins and capital structure proposal.</li> <li>Make adjustments to the valuation according to the outcome of due diligence.</li> </ul>
Exit	<ul style="list-style-type: none"> <li>In-depth forecast of market conditions and external factors at the exit year, which can impact EBITDA and hence the exit multiple.</li> <li>Compare the exit returns with other deals and identify possible interested buyers.</li> <li>Re-assess an IPO exit.</li> </ul>

### Red Flags

- Valuation might be smaller and might have considerable differences from the LBO model.
- Analysis of all the deals within the nursing home sector and possibility of low number of interested parties for this deal.
- Attention not only to the specific market factors but also to the politics and the country where the company is inserted.

### Providers

J.P.Morgan

Expected Duration:  
8 weeks

# Individual Paper | Private Equity Challenge

If I had any doubt about which thesis I should perform in the master, after participating in the Private Equity Course, I became sure that the Private Equity Challenge would be the best choice. Given this, on September of 2019 I started this challenging thesis and I have never looked back since.

For me, this thesis was about challenges, ambitious goals and competing with myself. It was also a huge learning experience where I have grown personally. I appreciated the environment where I could always feel as part of a team and got access to the best learning tools. It was also the best environment to learn with the best professors and my team. I was sure about the group I have chosen but when I look back at this 4 months I become even more sure about this choice. It is a group where you could never feel sad, exhausted or not motivated and where any doubt or insecurity was discussed. All the long nights were worth with this group. We pulled each other always up, the true meaning of friendship and help - a team. This project is a small metaphor for my 4 year experience at Nova. Arriving from a small village into an international capital, Nova was a key component of my life and growth in these recent years. Not only due to the time spent, but also from the various skills learned and the friendships forged.

With this experience, I understood that for succeeding at all levels one must work hard and have self-discipline, even when not motivated or feeling exhausted. I pushed myself to the limit and managed to successfully conciliate this demanding thesis with an internship and my personal responsibilities. Complementary, I also learned important values which define me today as a person and as a future professional. Being able to do this challenging thesis allowed me to work hard, overcome difficulties, challenge myself and improve my analytical and problem-solving skills. I recognize this Private Equity Challenge as highly challenging, and for that reason, I can proudly say that I have exceeded it and surpassed myself at different levels. Personally, there is nothing more rewarding than the feeling of achievement and mission accomplished.

**Marta Maria Ortigão Costa Ribeiro**